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ECONOMIC ISSUES AND THE CONSTITUTION

by William Wallace¹
March 10, 2000

I. Introduction

A well-designed constitution forms the strategic meta-law (or rules for making rules). Given the importance of consistency, stability and predictability for economic behavior it could be argued that virtually every provision in a constitution has economic content. Key issues in the separation of powers, judicial oversight and the design of checks and balances may be particularly critical to providing the kind of consistency, stability and predictability that foster economic growth and development. "...material advancement is as much affected by the choice of the economic, legal, and political institutions under which people live and work as it is by resource endowment and technological progress."²

The Indonesian people may be aware as never before of the problems resulting from the lack of a system built on the rule of law the "Negara Hukum" of the constitution and perhaps more fundamentally a constitution that provides an effective underpinning for these laws.

"Indonesia's catastrophic economic crisis has been widely perceived as stemming from the failure of the New Order regime to provide transparent, just and predictable administration."³ And this situation persists. Uncertainty over the execution of legal rights of debtors and creditors continues to create an impasse in the area of corporate debt restructuring with implications for the speed and sustainability of the recovery more broadly. There are equally pressing legal and constitutional issues related to relationships between levels of government. Thus Goodpaster (1999) indicates: "The sense now, however, is that the existing method of governance has run its course and is not as successful as it once was, and that Indonesia now needs to turn to new methods of governance."⁴

Perhaps key to governance is the constitution and the meta-law it provides and Indonesia is now looking to amending its constitution to deal with inadequacies in constitutional guidance. There are a number of areas for constitutional review that stand out as particularly critical to promoting effective national integration and sustainable growth. The move to decentralize decision-making has already begun the process of granting substantial autonomy to Provinces and Kabupatens throughout Indonesia. The current constitution's Article 18 may provide an inadequate for establishing the separation of powers between the National Government and the Provinces/ Regions as elucidated in Laws 22 and 25. This issue has a number of dimensions ranging from the most basic definition of the rights and

¹ PEG is a USAID-funded Project with the Government of Indonesia. The views expressed in this report are those of the author and not necessarily those of USAID, the U.S. Government or the Government of Indonesia.

² A review of Scully, Gerald W., **Constitutional Environments and Economic Growth**, Princeton University Press, Princeton, 1992.

³ Lindsey, Timothy, "From Rule of Law to Law of the Rulers – to Reformation?" in **Indonesia Law and Society**, Federation Press, 1999, p. 19.

⁴ Goodpaster, Gary, "The Rule of Law & Economic Development," p. 24.

responsibilities of each level of government, but most turn around what are known in US as the SUPREMACY and COMMERCE Clauses.⁵

Second, the constitution's existing provisions on Individual Rights (Article 27) may be inadequate in terms of clearly outlining individual rights broadly and with respect to EQUAL PROTECTION, DUE PROCESS, and protection from unlawful seizure (TAKINGS) Clauses of the sort specified in the U.S. Constitution for example.

Less immediately critical but still important deficiencies in the current constitution's economic content might be found in the checks and balances between the legislative and executive branch on budgeting as implied by Article 23 on Finance (in the U.S. these issues are dealt with under POWER TO TAX AND SPEND). The current Indonesian situation may require special "constitutional" rules agreed to by both parties based on fiscal sustainability situation currently.⁶ The guidance to overall economic policy found in Article 33 on Social Welfare might be rethought as well.

II Regional Autonomy, the Constitution and Economic Welfare

This is clearly the most important and pressing area of concern. Some historical background might be usefully gained by comparing and contrasting the US and the Indonesian Constitutions, including the recent Laws 22 and 25.

A bit of history

The U.S. Constitution was drawn up in 1787 almost 10 years after the States had drawn up articles of Confederation during the American Revolution (1777). In putting together the Articles the members of the First Continental Congress were very suspicious of a strong central government. "... the Articles purposely established a "constitution" that vested the largest share of power to the individual states. ...the Articles denied Congress the power to collect taxes, regulate interstate commerce and enforce laws. Eventually, these shortcomings would lead to the adoption of the U.S. Constitution."⁷ In particular "The United States had no power to regulate commerce between and among the states, leading to bitter tariff wars between them. This type of infighting did not help alleviate the economic depression that set in after the war ended."⁸

Thus the U.S. Constitution began as a meeting in Annapolis of a number of States to deal with exactly these difficult interstate commerce issues. They perceived that this limited focus was not sufficient to deal with the breadth of issues facing them and then called for a wider Constitution convention. However, commerce problems were among, if not the, core problem addressed by the U.S. Constitution.

In addition the U.S. Constitution was written by Americans imbued with the religion, philosophy and ideas of their day. "There is a hearty Puritanism in the view of human nature

⁵ Also important to regional decentralization are issues in the Export/Import Clause, the Contracts Clause, and perhaps something called a Debt Clause.

⁶ The U.S. debate here would be about the need for a balanced budget amendment, but other less restricting procedures could be envisioned. See World Bank, Public Expenditure Review [*correct citation and consider moving to section on this later in the memorandum.*]

⁷ Downloaded from Milestone Historic Documents – The Articles of Confederation
www.earlyamerica.com/earlyamerica/milestones/articles

⁸ Op. cit., www.usconstitution.net.consttop_arti.html

which pervades the instrument of 1787 It is the work of men who believed in original sin, and were resolved to leave open for transgressors no door which they could possibly shut.”⁹

Thus the delegates started their work from the viewpoint of the individual States and with a view of human nature as fundamentally fallible. When they wrote the U.S. Constitution they carefully conceded limited powers to the national government, put a number of constraints on the Congress and accepted some for themselves (especially in the commerce areas that had begun this process).¹⁰ Specifically the Constitution takes the form of providing some things that the National legislature is empowered to do (Section 8 -- Powers of Congress), some limits (Section 9 – Limits on Congress) and constraints on the States own behavior (Section 10 – Powers prohibited of States). This is strengthened by the 10th Amendment to the Constitution that reserves to the States anything not explicitly mentioned anywhere else.¹¹

Decentralization in Indonesia

Indonesia is in more or less the opposite situation. The 1945 Constitution explicitly identifies Indonesia as a Unitary State and indicates “Indonesia will not have within its jurisdiction areas with the character of “states””.¹² However, by the 1990s Indonesia faced virtually the opposite problem of the U.S. In the context of reformation and based on resentment over excessively centralized decision making and financial control, pressure from the regions and rising separatist pressures led to the Central Government’s introduction of Regional Autonomy Laws 22 and 25.

Based on the situation in Indonesia we might have expected the DPR to take the opposite approach to that taken in the U.S. This would have involved the DPR assigning a limited set of tasks to the regional governments (Provincial and Kabupaten), indicating the limits on the region’s powers, a set of limits to the DPR’s (or even MPRs) own power, and a reserve clause that claimed everything else for the central government.

However, the new decentralization laws take an approach that is philosophically closer to the U.S. one and not one that would have been expected in this situation. For example, Chapter IV, Article 7 on Regional Authorities states:

- (1) Regional Authorities shall cover the authorities in all fields of governance, except authorities in the fields of international policies, defense and security, judicature, monetary and fiscal, religion and authorities in other fields.
- (2) Authorities in other fields as intended in paragraph (1) shall cover the policies on national planning and macro national development control, financial balance fund, state administration and state economic institutional systems, human resources development, natural resources utilization as well as strategic high technology, conservation and national standardization.

⁹ **James Bryce** (1838–1922), British historian, politician, diplomat. *The American Commonwealth*, vol. 1, pt. 1, ch. 26 (1893), said of the U.S. Constitution. Bryce was here agreeing with the opinion of one—unnamed—who said that, “the American Government and Constitution are based on the theology of Calvin and the philosophy of Hobbes.”

¹⁰ Interestingly many of these people had been responsible for the earlier Articles of Confederation and their own State Constitutions, leaving them well prepared for this job.

¹¹ Amendment X – States Rights “*The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.*”

¹² The Elucidation of Article 18, “The 1945 Constitution of the Republic of Indonesia”, Department of Information, Republic of Indonesia, English Translation.

In essence the National government reserved a set of possibly limited, and ambiguous, tasks for itself. This is done while conceding everything else to the region with no clear limits and no reserve powers clause. This uncertain, and confusing, delegation of possibly vast powers (depending particularly on the interpretation of (2)) to the regions has triggered a great deal of uncertainty about the process¹³, even to the point of threatening the government's fiscal position in the view of foreign donors.¹⁴

In addition the national government effectively lays out the respective roles of the Provinces and Kabupatens.¹⁵ For example Article 11

- (1) The authorities of Regency Regions and Municipal Regions shall cover all governance authorities other than authorities excluded in Article 7 [above] and set forth in Article 9 [on Provincial Authority – basically coordination, and areas that the regencies are not able to take on yet.]
- (2) Governance field that must be performed by Regency Regions and Municipal Regions shall include public works, health, education and culture, agriculture, communication, industry and trade, capital investment, environment, land, co-operative and manpower affairs.

Again there is no focus on restrictions to regional power, or a clear determination of the level of government that would dominate in the event of a conflict in legal or regulatory or procedures or on how to evaluate such a conflict.

Decentralization, Internal Barriers to Trade and Local Discriminatory Action¹⁶

When delegating power the National government usually limits the local government's power to interfere with national goals and activities. These national goals usually include (1) national economic policy, (2) Harmony among political subdivisions, and (3) protection of the rights of citizenship related to the mobility within the nation. The key national priority is maintaining an integrated internal economy by not allowing regional and local governments to interfere with internal or international trade.

However, the implication of Laws 22 and 25 is that:¹⁷

“... increasing local legislative and executive law making authority means a proliferation of differing laws and regulations across Kabupatens and regions. [However] Mere differences in laws are not matters of concern – except in those areas where laws should be uniform across the country or where local laws interfere with some national interest.” And “With decentralization, there is, however a substantial risk that local interests through enactments of laws or through local executive action,

¹³ “It could be chaotic.” Uddin Ahmad, Ehtisham IMF advisor on financial affairs in Indonesia's Plan to Decentralize Worries Lenders, Asia Wall Street Journal, March 21, 2000.

¹⁴ “Kekhawatiran Bank Dunia itu cukup beralasan karena pengalihan penerimaan kepada pemerintah daerah akan mengurangi kemampuan membayar kembali (repayment) pemerintah pusat.” And “Saya tidak berbicara tentang modal swasta, tetapi Bank Dunia akan memperhitungkan risiko tersebut.” Bisnis Indonesia, Tuesday March 21, 2000.

¹⁵ The alternative might have allowed each successive government to determine the powers and restrictions on the levels below it.

¹⁶ This section essentially paraphrases (and then directly quotes) the introduction to Goodpaster, Gary, “Decentralization, Internal Barriers to Trade and Local Discriminatory Action”, PEG Working Paper December 1999.

¹⁷ The following three quotes from Goodpaster, pg. 1-2.

may trump national interests.” And in particular “... internal trade barriers and local discriminations against citizens operate to destroy the integrity and solidarity of a nation.”

With the following broader implication:

“For these reasons, the central government should reserve to itself the authority to undo local actions whenever they demonstrably injure clear national interests.”

And, even more fundamentally:

“... regarding local interference with domestic trade and regarding local discriminations against citizens. For the most part, the United States treats these issues as matters of Constitutional Law. Indeed, they are for they ultimately deal with the very constitution of the state, with power arrangements between governments, with the separation of powers between governments in the nation, and with the rights of citizens. ... All of these matters fall under what is called the ‘DORMANT COMMERCE CLAUSE’ jurisprudence. The supreme court of the United States, and lower federal courts, have taken on the responsibility of insuring that the union of states remains a free trade union and that citizens of one state in the United States are treated with equality and fairness when they undertake business or sojourns in other states.”

Clauses in the U. S. Constitution Related to Regional Autonomy

The United States Constitution is not the only approach to these issues but it does provide a starting point in looking at issues in providing a framework for Regional Autonomy.

The SUPREMACY Clause

“This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.”

Thus despite the genesis of the American Constitution in the states it was prescribed that national laws (and in particular the Constitution) would prevail over state ones in the case of conflict. Given the impossibility of envisioning everything in any law this would seem to be a very important provision and in line with Goodpaster’s suggestion.

The COMMERCE Clause

The U.S. Government describes the COMMERCE Clause as follows¹⁸:

“This clause serves a two-fold purpose: it is the direct source of the most important powers that the Federal Government exercises in peacetime, and, except for the due

¹⁸ The clause itself is quite short and reads “To regulate Commerce with foreign nations, and among the several states, and with the Indian Tribes:”

process and equal protection clauses of the Fourteenth Amendment, it is the most important limitation imposed by the Constitution on the exercise of state power.”¹⁹

Ultimately this clause has come to have two senses. First, it has prohibited States from passing laws or regulations with either the direct or indirect effect of inhibiting domestic or international trade. Second, more recently it has provided the rationale for National government regulation of trade.

Citing the U.S. government explanation of this evolution in thinking:

“Of the approximately 1400 cases which reached the Supreme Court under the clause prior to 1900, the overwhelming proportion stemmed from state legislation.\578\ The result was that, generally, the guiding lines in construction of the clause were initially laid down in the context of curbing state power rather than in that of its operation as a source of national power. The consequence of this historical progression was that the word “commerce” came to dominate the clause while the word “regulate” remained in the background.”²⁰

However in the U.S. context commerce has come to be interpreted much more broadly than the trade in goods taken literally.

“Not only, then, may transactions be commerce though non-commercial; they may be commerce though illegal and sporadic, and though they do not utilize common carriers or concern the flow of anything more tangible than electrons and information.” United States v. South-Eastern Underwriters Assn., 322 U.S. 533, 549-550 (1944).²¹

It has also reached quite deeply into the States own affairs:

“...in Gibbons v. Ogden, Chief Justice Marshall observes ‘it is obvious that [c]ommerce among the states cannot stop at the exterior boundary line of each state, but may be introduced into the interior.’”²²

Finally, the National government also limited the States ability to tax in ways that defended interregional commerce.

“In the exercise of its taxing power, a State may not discriminate substantially between residents and nonresidents. In Ward v. Maryland,\210\ the Court set aside a state law which imposed specific taxes upon nonresidents for the privilege of selling within the State goods which were produced in other States. Also found to be incompatible with the comity clause was a Tennessee license tax, the amount of which was dependent upon whether the person taxed had his chief office within or without the State.\211\ In Travis v. Yale & Towne Mfg. Co.,\212\ the Court, while sustaining the right of a State to tax income accruing within its borders to nonresidents,\213\ held the particular tax void because it denied to nonresidents

¹⁹ This and the following quotes are drawn from the Elucidation of the Constitution of the United States downloaded from www.access.gpo.gov/congress/senate/constitution/art1.html. Quoting Prentice and J. Egan, The Commerce Clause of the Federal Constitution (Chicago 1898). Pg.160

²⁰ Ibid, Pg. 161

²¹ Ibid, Pg. 162

²² Ibid, Pg. 163

exemptions which were allowed to residents. The “terms ‘resident’ and ‘citizen’ are not synonymous,” wrote Justice Pitney, “. . . but a general taxing scheme . . . if it discriminates against all [[Page 877]]nonresidents, has the necessary effect of including in the discrimination those who are citizens of other States; . . .\214\ Where there were no discriminations between citizens and non-citizens, a state statute taxing the business of hiring persons within the State for labor outside the State was sustained.\215\ This section of the Constitution does not prevent a territorial government, exercising powers delegated by Congress, from imposing a discriminatory license tax on nonresident fishermen operating within its waters.\216\”²³

Overview of the COMMERCE Clause²⁴

While this is a very difficult area in the details the essential issues boil down to two:²⁵

- Regions may not discriminate against interregional trade,
- Even where regional rules do not discriminate against interregional trade they may not “adopt rules that place a significant burden on such trade.”

General areas of concern and examples are laid out in this paper, but generally cover two areas.

There is a class of actions that constitute local protectionism either direct or indirect at the expense of out-of-region providers of the same goods or services. These can be on trade directly, on entry restrictions, on differential tax rules, through discriminatory regulations (health, transportation, etc), or by forcing reciprocal trade with another region. Two areas seem to be acceptable. First, localities can assist local industries through subsidies (although not through tax breaks under U.S. law) and through the localities own behavior, purchasing etc.

The second class of actions concerns Trade and Taxation rules. This is more complicated since there are legitimate claims (and needs) for some tax authority. Two problems arise:

- Taxes on through trade (with trade through a number of regions the problem of compounding would seem clear),
- Discriminatory taxes (depending on the definition, this would be a version of the kind of protectionism proscribed above).

Depending on the definitions both should be considered restraints on trade. However, it may not be practical to determine these in many cases and some carefully described rules may be needed here (although not in the Constitution) see Goodpaster for more details.

Regulation and control of Exports and Imports to the Nation

This is actually an element Commerce Clause that gives the National government supremacy over both foreign and domestic trade but is reinforced in the section of the Constitution that deals with Powers prohibited to the States (Section 10).

²³ Ibid, pg. 162.

²⁴ Such a mechanism, or a Law is proposed as a Domestic Trade Commission in Looking to the Future of the Indonesian Economy, Bappenas (1999), pg. 63.

²⁵ The rest of this section again paraphrases Goodpaster (1999).

“No State shall, without the Consent of Congress, lay any Imposts or Duties on Imports or Exports, except what may be necessary for executing its inspection laws; and the net produce of all Duties and Imposts, laid by any State on Imports or Exports, shall be for the Use of the Treasury of the United States; and all such laws shall be subject to the Revision and Control of the Congress.”

The current climate in Indonesia makes this a particular area of concern as there are recurring efforts by the Provinces to restrict imports of a number of agricultural commodities, at potential risk the nation’s overall compliance with any number of international agreements, most notable that with the International Monetary Fund.

Contracts and Debt

Two other clauses that arose out of the special circumstances of the U.S history at the time of the Constitution may be important to Indonesia today.

Contracts

Article I – The Legislative Branch, Powers prohibited of States indicates that:

“No state shall enter into any Treaty, Alliance, or Confederation; grant Letters of Marque and Reprisal; coin Money; make any Thing but gold and silver coin a Tender in Payment of Debts; pass any Bill of Attainder, ex post facto Law, or *Law impairing the Obligation of Contracts*, or grant any Title of Nobility.”²⁶

Debt

Article I – The Legislative Branch
Section 8 – The Powers of Congress

The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, ***to pay the Debts and provide for*** the common Defense and ***general Welfare*** of the United States; but all duties, impost and Excises shall be uniform throughout the United States.

Article VI. The United States

“All Debts contracted and Engagements entered into, before the Adoption of this Constitution, shall be as valid against the United States under this Constitution, as under the Confederation.

“The power to pay the debts of the United States is broad enough to include claims of citizens arising on obligations of right and justice. ...Curiously enough, this power was first invoked to assist the United States to collect a debt due to it. ... In *United States v. Fisher*, the Supreme Court sustained a statute that gave the Federal Government priority in the distribution of the estates of its insolvent debtors. ... Invoking the “necessary and proper” clause, Chief Justice Marshall deduced the power to collect a debt from the power to pay its obligations by the following reasoning: “***The government is to pay the debt of the Union, and must be authorized to use the means which appear to itself most eligible to effect that object.***” It has,

²⁶ It is not really an economic issue per se, but at the time the Constitution was written the drafters were afraid of the states forming internal groups that might challenge the national government and thus limited their rights in this clause. The Indonesian Regional Autonomy makes this an explicit right of the Provinces and Regencies.

consequently, a right to make remittances by bills or otherwise, and to take those precautions which will render the transaction safe."^{27 28}

The problems in the United States in the aftermath of the Revolution have some relationship to the problems of Indonesia today. Under the Articles of Confederation the National government could not get the revenues required to meet its debt obligation acquired to finance the Revolutionary War. In addition, there were fears of populist pressure to repudiate contracts on the parts of the states. This is mirrored by possible provincial review and rejection of existing contracts (foreign and domestic) in Indonesia. And the problems around possible payment of the national debt are already being raised and posing a threat to macroeconomic stability. [Footnote 13] These special circumstances might argue for the requirement of similar specific clauses limiting the right of the States to arbitrarily break contracts²⁹, and the prior claim of the central government to any revenues required to meet its foreign and domestic debt obligations.

II Economic certainty and Equal Protection, Due Process and Just Compensation

This is the second major area of possible amendment to the constitution in line with issues related to personal liberty and associated property rights. Again this appears to be an area of significant problems because of grievances associated with insufficiencies in this area. It is clear that people's discount rates and therefore investment respond to uncertainties regarding their claims over assets. The weaker the claim and the weaker the inability to defend a legitimate claim the higher the discount rate, and the fewer, and perhaps riskier projects that will be undertaken.

These areas did not exist in the U.S. Constitution per se, but were added as part of the Bill of Rights (the first ten amendments) and in the strongest form in the Fourteenth Amendment. These state:

Fifth Amendment—Trial and Punishment

- Compensation for Takings – “Nor shall private property be taken for public use, without just compensation.”

Fourteenth Amendment – Section 1

- “All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. *No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.*”

Related to Equal Protection, but also related to restrictions on the Powers of the Regions the Constitution under the PRIVILEGES AND IMMUNITIES Clause (Article IV – the States) indicates that:

²⁷ Elucidation of the Constitution of the United States downloaded from www.access.gpo.gov/congress/senate/constitution/art1.html.

²⁸ The NECESSARY AND PROPER clause grants Congress the right “To make all Laws which shall be necessary and proper for carrying into execution the foregoing Powers, and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof.”

²⁹ This raises the issues of DUE PROCESS and TAKINGS raised immediately below.

- ***“The citizens of each State shall be entitled to all Privileges and Immunities of the Citizens of several States.”***

*Overview and Summary of this area:*³⁰

Practically speaking Goodpaster (1999) suggests that in the interests of creating national unity there should be some principle that regional governments cannot discriminate against Indonesian citizens, who are regional nonresidents, in matters fundamental to interregional harmony.

In principle, the law must, therefore, impose and defend some strong baseline principle of equality between citizens no matter what their place of origin within Indonesia.

At a minimum:

- (1) Own, possess, and dispose of property;
- (2) Engage in gainful employment or business in the private sector;
- (3) Do business on terms of substantial equality with region citizens;
- (4) Travel through and within a region, including the right to change residence from one region to another;
- (5) Be treated equally by justice institutions;
- (6) Seek medical care.

Finally “In matters of importance, the rights of Indonesians, as citizens of Indonesia, must trump [prevail over] the authority of local governments to favor their own citizens over other citizens of Indonesia. To do otherwise would only encourage separatist tendencies and create hostility, conflict, distrust of government, and disbelief in the ability of government to secure the rights of citizens.”

An area that might want to be anticipated here includes the area of affirmative action. The Indonesian constitution Article 27 Section 1 indicates:

“Without any exception, all citizens shall have equal positions in Law and Government and shall be obliged to uphold that Law and Government.”

A priori this would imply that affirmative actions based on a priority for one citizen over another based on non-objective and possibly irrelevant criteria such as (religion, race, ethnicity, etc) would be unconstitutional in Indonesia as they are in the US. However, US law has apparently held that under certain circumstances affirmative action (violation of the equal protection law) might be justified if injury can be shown. However, such provisions should be clearly defined and limited.³¹

³⁰ Again this summary draws almost entirely on Goodpaster (1999) and the quotes are drawn from him.

³¹ Conversation with Goodpaster, March 2000.